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Developers abandoning condo deals

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For the past two years, the Chetrit Group has been moving full-steam ahead with plans to convert the Empire Hotel into 125 luxury condominiums. But now that fast-paced condo sales have braked, the developer is switching gears and repositioning the dowdy building across from Lincoln Center as a 440-room upscale hotel.

More developers are finding that the speediest exit strategy from the faltering condo market is to sell their projects to hotel operators anxious to expand in New York. In some cases, developers have tried to market their projects to condo buyers first but end up choosing to cash out quickly because of sluggish sales. Others, like the Chetrit Group, are making the move even before they begin marketing. The company did not return calls for comment.

"Real estate developers go wherever the money is, and right now they see hotels as the bloom on the rose," says John Fox, a senior vice president at PKF Consulting.

Though a handful of small condominium projects have already been converted into boutique hotels, the Empire shows that the trend is catching on with bigger developments. It is the third such conversion in as many months. Most recently, the Philadelphia-based hotel group Korman Communities acquired a condominium project on Sutton Place when sales there stalled. In September, the Global Hyatt Corp. bought 485 Fifth Ave. when buyers failed to materialize.

The three projects promise to create more than 700 hotel rooms.

The number of condos on the market has surged 69.7% in the past year, to 3,943 units, and is expected to keep rising. In the third quarter, condo sales fell 7%, to 1,026, and listings were on the market an average of 4% longer, or 155 days, according to appraisal firm Miller Samuel.

On the other hand, the New York hotel market is experiencing tremendous demand. The average cost of a room is an unprecedented \$260 a night, and the average occupancy rate is 88%, according to PKF Consulting.

Looking at sites

"We have been approached by a number of clients to evaluate sites for hotel use that had once been slated for condominium development," says Sean Hennessey, the chief executive at Lodging Investment Advisors.

The recent sale of the W New York-Union Square is fueling the fire. Istithmar, an investment group owned by the government of Dubai, paid a record-breaking \$285 million for the hotel, at East 17th Street and Park Avenue South.

"The W deal represents the first time in Manhattan that a hotel was sold for more than \$1 million a room," Mr. Hennessey says. "For many projects, we've reached a crossover point where hotel use is more valuable than residential."

Belfonti Capital Partners and the Carlyle Group reached that point after selling just under half of the condominiums that they had planned to build at 485 Fifth Ave.

"They could wait it out another two years to sell the remainder of the units or receive an immediate return on their investment by selling to Hyatt now," says Mark Gordon, a managing director at investment bank Sonnenblick Goldman, which represented Belfonti and Carlyle in the \$136 million deal.

Quick route to profits

A Hyatt spokeswoman says the company hasn't completed its plans for the building.

Alchemy Properties, which had intended to convert the former Sutton Hotel on East 56th Street into condo units, also chose the quick route to profits. The firm sold the building to Korman for \$84 million rather than wait for all the units to sell.

"We received about 10% less by selling it as a hotel, but it was easy and profitable," says Kenneth Horn, president of Alchemy.

But a hotel sale may not be the only option for developers faced with a stagnant condo market. Residential rents have jumped as much as 15% in the past year and are expected to keep rising. Though they're not high enough yet to cover most builders' expenses, the gap is closing.

"If you bought land in the past 24 months, you have paid through the nose, and right now rents don't pencil in," says Peter Von Der Ahe, a director at Marcus & Millichap. "In most cases, developers are not well-capitalized enough to wait until rents rise, so a hotel sale is a more immediate solution."

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